

Internal Revenue Service

Department of the Treasury

District
Director

Delaware-Maryland District

37 Hopkins Plaza - Baltimore, MD 21201

PERSON TO CONTACT

CONTACT TELEPHONE NUMBER

CONTACT REFERENCE TO

DATE

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

The information submitted indicates that you were incorporated on [REDACTED]

Your purpose as stated in your articles of incorporation is "to provide services for child welfare or social welfare." Said corporation is organized and operated exclusively for charitable, religious, educational and scientific purposes, including for such purposes the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code or the corresponding section of any future Federal tax code.

According to your Articles of Incorporation and Bylaws, you are not a membership organization. Your income will consist of fees for services rendered and your expenses will consist of costs associated with the services provided.

In describing your activities, you indicated that you will affiliate with child and youth agencies to provide services to foster children, interact directly with [REDACTED] to ensure compliance with their contracts with child and youth agencies, provide staff personnel to interact directly with the child to ensure the child's needs are met, provide direct services to foster families, natural families, other private child and youth agencies, and [REDACTED] children and youth agencies, perform functions for individual foster child service plans, determining family service plans, specialized training, psychological testing of foster children, etc.

(Rev. 8-50) Correspondence Approval

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will assist child and youth agencies to ensure compliance with children and youth agency contracts. [redacted] will be a provider of service to foster parents for the affiliated child and youth agency. [redacted] will ensure that foster parents are properly trained to comply with [redacted] regulations, and will also ensure that the children have a clean, safe, and healthy environment by certifying the foster parent homes are in accordance with [redacted].

In response to our request for additional information, you stated [redacted] fees will be based on the amount of services requested and needed by foster children and the organization is who contract with [redacted]. In another response, you stated, [redacted] does not have a fee schedule. The fees are allocated based on cost, with a variable percentage markup to cover fixed overhead costs. Regarding any fundraising activities, you indicated on Form 1023 that the organization does not intend to solicit funds at this time.

You will initially contract with [redacted] to provide services to foster children. Both of these organizations were created by [redacted] who is the founder of [redacted]. In fact, [redacted] owns [redacted] x of the shares of [redacted]. Also, the same individuals serve as members of the governing body of all three organizations.

The specific services provided, thus far, to [redacted] are strategic planning, both in the sense of long term planning and short term tactical planning since July 1, 1994. [redacted] provided a consultant in the name of [redacted], and others, and have arranged for their appearance before [redacted] board of directors, and its employees, established a line of credit in the amount of \$500,000.00 which has been available to and utilized by [redacted]. [redacted] recruited more board members for [redacted] at its request, and has been involved in the planning and discussion of the reconstruction and restructuring of the agency including helping to design programs to obtain alternative services.

Subsequent information disclosed that [redacted] has expanded its activities to include adoption services. These services will be provided to private contracting agencies and other non-profit corporations.

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Federal income tax for organizations which are organized and operated exclusively for charitable, religious, and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Thus, in construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court of the United States stated, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operations of such trade or business are in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of activities which are in furtherance of one or more exempt purposes.

While you are organized on a nonprofit basis, nonprofit is not the same as exempt. The fact that you do not make a profit is not the controlling factor. See United States v. La Societe Francaise de Bien, Mut., 152 F. 2d 243 (9th Cir. 1945), cert. denied 327 U.S. 793 (1946); Hassett v. Associated Hospital Service Corporation, 125 F. 2d 611 (1st Cir. 1942), cert. denied 316 U.S. 672 (1942); Baltimore Health and Welfare Fund v. Commissioner, 69 T. C. 554 (1978); and B. S. W. Group, Inc. v. Commissioner 352 (1978).

In Better Business Bureau v. United States, 326 U.S. 279-283, (1945), the court held that the existence of a single non-exempt purpose, if substantial in nature, will destroy exemption under section 501(c)(3) regardless of the number or importance of truly exempt purposes.

In Scripture Press Foundation v. United States, 61-1, USTC 9195, the court was asked to consider whether the activities of a certain publishing company were primarily educational and charitable rather than business activities with a commercial purpose. The organization sold its publications at a price above their actual cost, or at a price that included a markup which established a profit. The court indicated in this case that the existence of profits gives some evidence that a business purpose rather than an educational purpose is primary.

In P.S.W. Group v. Commissioner, 70 T.C. 532 359 (1978), the court held that an organization that provided management and consulting services to nonprofit organizations at fees set to cover costs and yield a 10.8 percent profit was not organized and operated exclusively for charitable and educational purposes. Furnishing the services at cost or above cost lacked the donative element to be considered charitable. The court also stated that the presence of substantial profits constitutes evidence that an organization is operating for a commercial rather than exclusively educational purpose.

Revenue Ruling 72-369, published in Cumulative Bulletin 1972-2, on page 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code.

While you originally described your activities as providing care and assistance to foster children, your actual activities are those of a sub-contractor, in which, you provide services, on a regular basis, for a fee. Your activities are not exclusively within the intendment of the Code. Revenue Ruling 72-369 SUPRA

As in Scripture Press Foundation and B.S.W. Group, your organization's fees are based on cost with a "mark-up". Though you may not be making a substantial profit, the fact that your services are not below cost is signficatory of a trade or business.

An organization is not exempt merely because its operations are not conducted for the purpose of producing a profit. To satisfy the "operational test" the organizations' resources must be devoted to purposes that qualify as exclusively charitable within the meaning of section 501(c)(3) of the Code.

The fact that the services in your case are provided at cost and currently for exempt organizations is not sufficient to characterize your activity as charitable within the meaning of section 501(c)(3).

By furnishing the services at cost, you lack the donative element necessary to establish that your activities are characteristic of a charitable organization. Therefore, you have failed the "operational test" required under this section of the Code.

Hence, we have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code. In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

Contributions to your organization are not deductible by donors under section 170(c)(2) of the Code.

In accordance with the provisions of section 6104(c) of the Code, a copy of this letter will be sent to the appropriate State officials.

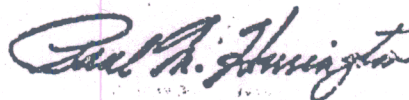
If you do not agree with our determination, you may request consideration of this matter by the Office of Regional Director of Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892. Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office. If you will be represented by someone who is not one of your principal officers, that person will need to file a power of attorney or tax information authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

If you have any questions, please contact the person whose name and telephone phone number are shown in the heading of this letter.

Sincerely,



Paul M. Harrington
District Director

Enclosure: Publication 892

cc: [REDACTED]

cc: [REDACTED]